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Complex Litigation: CAFA “Carve-Outs”

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Complex Litigation

In the 18 months since Congress enacted the Class Action Fairness Act of 2005, Pub. L. 109-2, 199 Stat. 4 (2005), federal courts have focused on construing which parties carry the burden of proof on removal; what events trigger commencement of an action within CAFA jurisdiction; determining CAFA's amount-in-controversy requirements; mass actions; and the timing of appeals from CAFA orders.

CAFA provides for new original and removal federal jurisdiction for class action litigation. Federal courts, until recently, have been consumed with the array of threshold statutory issues, and have deferred consideration of numerous so-called carve-outs and exceptions to CAFA jurisdiction. Recently, however, some federal courts have finally turned their attention to construing these CAFA provisions.

CAFA carve-outs and exceptions fall into different categories. The statute explicitly carves out some types of cases from federal court jurisdiction. There are two types of CAFA exceptions: situations in which courts must decline to exercise jurisdiction (mandatory exceptions), and circumstances in which the court may decline to exercise jurisdiction (discretionary exceptions).

CAFA to civil actions on or after Feb. 18, 2005

This column examines how courts have treated one type of CAFA carve-out, dealing with securities litigation, and one permissive qualification, dealing with duplicative class litigation. In my next column I will examine emerging judicial opinions construing the CAFA home state exception and local controversy exception. In the broader context, federal courts seem to be feeling their way through CAFA, searching for the appropriate allocation of complex litigation between federal and state courts.

CAFA applies to all civil actions commenced on or after Feb. 18, 2005. Federal courts do not have original jurisdiction over a variety of claims that deal with securities, internal affairs or corporate governance issues that arise under state law, or claims that relate to the rights, duties, and obligations created by a security. See 28 U.S.C. 1332(d)(9), setting forth three circumstances governing security-related litigation that are carved out from federal jurisdiction.

The security claim carve-outs also apply to removal litigation. See 28 U.S.C. 1453(d) (setting forth the same exceptions). A federal court, citing CAFA's legislative history, has noted that the carve-outs from original and removal jurisdiction are intended to be coterminous. **In re Textainer Partnership Securities Litig.**, 2005 U.S. Dist. LEXIS 26711, 13 n.4 (N.D. Cal. July 27, 2005)(citing S. rep. 109-14 at 50).

CAFA does not apply to any class action that solely involves claims related to the rights, duties and obligations relating to or created by any security, as defined under Section 2(a) of the Securities Act of 1933, 15 U.S.C. 77(b)(a)(1). See 28 U.S.C. 1453(d)(9)(c).

The U.S. District Court for the Middle District of Tennessee recently held that this CAFA security carve-out provision was unambiguous, and granted the plaintiff's request for remand to state court in a shareholder class action brought in the Chancery Court for Nashville that alleged a state law breach of fiduciary duty claim. **Indiana State District Council of Laborers and Hod Carriers Pension Fund v. Renal Care Group, Inc.**, 2005 U.S. Dist. LEXIS 24210,3 (M.D. Tenn. August 18, 2005). The court also rejected the defendant's argument that the case involved an embedded federal question. *Id.* at 4.

In a decision relying heavily on CAFA's legislative history relating to the security litigation carve-outs, the U.S. District Court for the Northern District of California similarly declined federal removal jurisdiction under two security carve-out provisions. **In re Textainer Partnership Securities Litig.**, 2005 U.S. Dist. LEXIS 26711, 11-25.

The plaintiffs brought suit on behalf of holders of limited partnership units, alleging a single cause of action under California law for breach of fiduciary duty, and relating to the defendants' proposed sale of partnership assets.

After attempted removal, the court held that the litigation came within two CAFA carve-outs: The claim related to the internal affairs or governance of a corporation or other form of business enterprise and arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized. 28 U.S.C. 1332(d)(9)(B) and 1453(d)(2).

The claim also was encompassed by the carve-out for security litigation involving a claim of breach of fiduciary duty. 28 U.S.C. 1332(d)(9)(C) and 1453(d)(3). **In re Textainer Partnership Securities Litig.**, 2005 U.S. Dist. LEXIS 26711, 16-25.

It is generally recognized that one purpose of CAFA is to expand federal court jurisdiction over class action litigation. **Aquilino v. Home Depot U.S.A., Inc.**, 2006 U.S. Dist. LEXIS 48554 6 n.1 (D.N.J. July 17, 2006). Congruent with this purpose, Congress also intended that federal courts deal with the problem of duplicative and repetitive class action filings by plaintiffs' counsel who commence such repetitive class actions within a short period of time. To this end, Congress qualified its mandatory remand provisions with language excepting repetitive class litigation filed within a three-year period. See 28 U.S.C. 1332(d)(4)(A).

The repetitive class action qualification modifies a CAFA provision that specifies when a federal court must decline jurisdiction. According to this complicated provision, a federal court must decline jurisdiction over a class action if the following requirements are met: (1) more than 2/3 of the proposed class members are citizens of the state in which the action was originally filed; (2) at least one defendant is a defendant (a) from whom significant relief is sought, (b) whose alleged conduct forms a significant basis for the claims, and (c) who is a citizen of the state in which the action was originally filed; and (3) the principal injuries resulting from the alleged conduct occurred in the state in which the action was originally filed. If these factual circumstances exist, a federal court must not retain jurisdiction over the class action. U.S.C. 1332(d)(4)(A).

However, this mandatory decline of federal court jurisdiction is qualified. Thus, even if all these requirements are satisfied, a federal court may retain jurisdiction if the plaintiff has, within a three-year period preceding the filing of that class action, filed another class action asserting the same or similar factual allegations against any of the defendants on behalf of the same or other persons. U.S.C. 1332(d)(4)(A).

The U.S. District Court for the Southern District of Illinois recently applied this repetitive-litigation qualification to deny a plaintiff's motion to remand an Illinois state class action that the defendants removed pursuant to CAFA. **City of Fairview Heights v. Orbitz, Inc.**, 2006 U.S. Dist. LEXIS 47085 (S.D. Ill. July 12, 2006). In **Fairview Heights**, the parties did not dispute that the various other elements of 28 U.S.C. 1332(d)(4)(A) were satisfied. However, the parties did contest whether the federal court should retain CAFA jurisdiction because the plaintiff, within a three-year period, had filed repetitive class action litigation against the same defendant.

Judge David R. Herndon, construing the repetitive-litigation qualification, determined that the defendant demonstrated that it had been subject to exactly the same litigation in a parallel California case. Examining the complaint in the parallel litigation, **City of Los Angeles v. Hotels.com, L.P., et al.**, Herndon concluded that the California class action involved the exact same defendants as in the Illinois case. The California case was filed in 2004, within the three-year window; and the California complaint contained not only similar factual allegations, but in some places identical wording and structure as the plaintiffs' Illinois complaint. **City of Fairview Heights v. Orbitz, Inc.**, 2006 U.S. Dist. LEXIS 47085, 7-8. In addition, the court found the two complaints core allegations to be almost exactly the same. *Id.* at 8.

Too early to assess impact of CAFA carve-outs

It is, of course, too early to assess the impact of the CAFA security carve-out on federal jurisdiction. To date, the security carve-out and its interpretation seems a straightforward application of the statute's intent to maintain a balance between appropriate federal and state jurisdiction over particular subject matter. The security litigation carve-out strikes the jurisdictional balance in favor of state court jurisdiction.

The duplicative-litigation qualification, however, strikes the balance in favor of federal court jurisdiction and manifests a desire to rein in plaintiffs' abusive practices of repetitive class action filings and patent forum-shopping. The application of this duplicative-litigation qualification requires a highly nuanced application of facts, and it remains to be seen how other courts, in other contexts, will examine duplicative class action filings either to retain or to decline federal jurisdiction.